

25 January 2022

Sarah Gillie  
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Electricity Authority  
By email to [Consult-2021DryYearReview@ea.govt.nz](mailto:Consult-2021DryYearReview@ea.govt.nz)

Dear Sarah

### **Consultation Paper— 2021 Dry Year Review**

1. This is a submission from the Major Electricity Users' Group (MEUG) on the Electricity Authority consultation paper "2021 Dry Year event review" published 14<sup>th</sup> December 2021 seeking feedback on the report by MartinJenkins (MJ) for the EA dated 27<sup>th</sup> October. The MJ review is included as appendix A of the consultation paper.<sup>1</sup>
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.

### **Overlap between the MJ review and the Wholesale Market Price Review**

3. The consultation paper sets out the scope of the review in paragraph [1.4] and exclusions in [1.5]. The scope in relation to "The dry year risk regime and incentives" [1.4 (c)] is elaborated further with reference to explicit policy settings in the System Operator Security of Supply Forecasting and Information Policy (SOSFIP), Emergency management Policy (EMP) and stress test regime. To the extent these relate to non-price issues, such as providing information to the market about fuel quantity suppliers for generators or identifying misunderstandings on information and or roles between the EA, Ministers Office and System Operator, the MJ review is a useful new addition to the broader debate on outcomes over the first half of 2021 (2021H1).
4. Where the MJ review is less helpful are where matters concerning price, the trade-off between price and security of supply, incentives (that are primarily driven by price) and risks of political uncertainty (driven by concerns on price) are discussed. Those matters, in our view, are better considered as part of the more comprehensive concurrent and ongoing Wholesale Market Price Review.

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<sup>1</sup> Document URL <https://www.ea.govt.nz/assets/dms-assets/29/Consultation-2021-Dry-Year-event-review-v2.pdf> at <https://www.ea.govt.nz/monitoring/enquiries-reviews-and-investigations/2021/2021-dry-year-event-review/consultations/>.

## MJ review findings on non-price issues

5. The following table lists actions proposed in the MJ review findings on non-price issues and MEUG’s response:

Actions proposed in MJ review findings	MEUG response
<p>“... the Authority should determine ... an absolute value at which point Transpower provides daily reporting ...” (p9-10)</p>	<p>Agree.</p>
<p>Actions on energy risk curves (ERC) (p12-13):</p> <ul style="list-style-type: none"> <li>• “... rationalising the different curves published ...”</li> <li>• “... value in agreeing a clear lead for informational resources, particularly for the Minister, to ensure consistency in language and messaging around the risk curves.”</li> <li>• Options to manage view that sudden curve movements undermined confidence.</li> </ul>	<p>MEUG is sceptical having another consultation to consider changes to the ERC will result in benefits exceeding the transaction cost. The Ministers office and EA can and should improve their co-ordination.</p>
<p>s.46 notices and “...value in the Authority and Transpower considering the implementation of an enhanced reporting regime for times of potential crisis.”</p>	<p>The review does not consider if the use of the s.46 notices was needed or effective during 2021H1. MEUG is sceptical the EA received any information from the s.26 notices that made any material difference to how the EA performed in 2021H1. We are also concerned the s.26 notice given to the System Operator may have undermined industry confidence in the independence of the System Operator.</p> <p>Once an event starts the best approach is to make sure key decision makers get the right information. Market participants, not the EA, are the key decision makers. Price is the best piece of information. The problem is a lack of confidence prices in 2021H1 were at levels expected in a workably competitive market. This issue is outside the scope of the MJ review.</p>

6. MJ also discussed perceptions by those interviewed on transparency of gas data. No recommended action was proposed as the review noted (page 13) “transparency of gas supply data has been well canvassed in fora outside this report, with new legislation and corresponding regulation set to take effect which may resolve this issue in the case of gas ...” MEUG agrees with this approach by MJ.

## MJ review findings on price, price-security trade-off, incentives, and political risk issues

7. The MJ review findings start with describing the scope of the review as considering factors that the market should be aware, expected incentives and therefore general direction of outcomes, but not reviewing whether observed price signals were “optimal.” Refer page 4:

“Our scope also did not include the regime’s overarching policy purpose. This means that, while industrials did choose to shutter production in order to reduce electricity demand and conserve generation capacity, this is not a system failure and in fact was the system working as intended. Whether the system **should** incentivise conservation to that degree at the levels of risk we saw is another question altogether and speaks to the risk appetite of the Electricity Authority and broader political system as to security of supply.”
8. Trying to review how the Authority, System Operator, suppliers, fuel suppliers for generators, consumers, Ministers and the media performed during the dry-period event without considering actual prices over 2021H1 is at the least difficult; and might even be considered irrelevant because if it wasn’t for the price levels observed, behaviours would have been markedly different had prices been lower. Despite stating the level of prices was outside the scope of the review, some MJ findings were a result of the actual price levels.
9. For example, MJ state (page 14):

“As the media and the public began to pay more attention, there was an opportunity for the regulatory system to take a stronger voice in reassuring people that both the market was working exactly as intended to preserve resources and ensure security of supply – and that the impact of high wholesale pricing was unlikely to be felt by them.”
10. Apart from being beyond the scope of the review as we understand it, there are two other concerns about this statement:
  - A presumption that “the market was working exactly as intended to preserve resources and ensure security of supply” cuts across the work-in-progress on the Wholesale Market Price Review. One of the most important outcomes of the Wholesale Market Price Review to date has been the discovery of an unexplained increase of up to \$38/MWh in spot prices. One of the possible explanations for this increment is the sustained exercise of market power by one or more suppliers. Neither the list of factors purported to have led to higher prices in the consultation paper [paragraph 2.4] or the environmental factors listed by MJ (pages 6 to 8) mention this unexplained \$38/MWh increment.
  - The statement that high spot prices in the Wholesale Electricity Market do not affect retail customers on fixed price variable volume contracts. That is true for those customers monthly bills received over 2021H2 but inevitably prices higher in the wholesale market will over time flow through to higher retail prices. Similarly, customers exposed to the spot price that manage that exposure with hedges will inevitably find high spot prices flowing through in higher hedge prices

The statement is not true for customers exposed to the spot price. While most of those customers are businesses, those businesses viability may be affected to the point they downsize or close and therefore indirectly householders employed by those businesses.

11. Another example of the review canvassing issues and making judgements on prices during 2021H1 is on page 8:

"No system will ever be resilient to any possible circumstance, and the incentive regime and regulatory environment created by the Authority sets a low appetite for risk around security of supply – as can be seen in generators acting to manage risk, preserve water, and negotiate for greater gas availability prior to even reaching a 1% chance of future shortage. Far from demonstrating a fragile system, the 2021 dry year event highlighted a well-functioning market which responded as expected to even minimal levels of risk."

12. Having stated on page 4 (see quote in paragraph 7 above) that the MJ review would not consider "... the risk appetite of the Electricity Authority and broader political system as to security of supply", the above quote says MJ considers "... the 2021 dry year event highlighted a well-functioning market ...". MEUG does not believe MJ can justify that statement based on the limited review undertaken.

13. It may be that the MJ review findings reflected the views of those interviewed that apart from government, regulators and the System Operator, included the largest seven suppliers.<sup>2</sup> There were no customers or small retailers interviewed. A supply side centric view in the review findings is on page 6:

"Markets thrive on certainty, which offers participants the confidence to make decisions without needing to include a significant risk premium in their prices."

14. This is a supply side centric view because it only mentions supplier prices being subject to a premium for the risk of political intervention. Had MJ interviewed small retailers and customers the long-standing question of whether sustained market power, by one or more suppliers, was a factor in observed prices (refer discussion in paragraph 10 above) would have been raised and a more balanced view may have emerged.

Yours sincerely



Ralph Matthes  
Executive Director

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<sup>2</sup> MJ review, p17, Appendix 1.